

Report  
of the  
Examination of  
CMG Mortgage Reinsurance Company  
Madison, Wisconsin  
As of December 31, 2002

## TABLE OF CONTENTS

	Page
I. INTRODUCTION.....	1
II. HISTORY AND PLAN OF OPERATION.....	3
III. MANAGEMENT AND CONTROL .....	5
IV. AFFILIATED COMPANIES .....	9
V. REINSURANCE .....	18
VI. FINANCIAL DATA.....	19
VII. SUMMARY OF EXAMINATION RESULTS .....	28
VIII. CONCLUSION.....	31
IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS.....	32
X. ACKNOWLEDGMENT .....	33



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*Jorge Gomez, Commissioner*

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October 28, 2003

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Honorable Jorge Gomez  
Commissioner of Insurance  
State of Wisconsin  
125 South Webster Street  
Madison, Wisconsin 53702

Commissioners:

In accordance with your instructions, a compliance examination has been made of  
the affairs and financial condition of:

CMG MORTGAGE REINSURANCE COMPANY  
MADISON, WISCONSIN

and this report is respectfully submitted.

## I. INTRODUCTION

The previous examination of the CMG Mortgage Reinsurance Company (also "the company" or "CMG Re") was conducted in 2001 as of December 31, 1999. The current examination covered the intervening period ending December 31, 2002, and included a review of such 2003 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Affiliated Companies
- Growth of Company
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comments on the remaining areas of the company's operations are contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

## **II. HISTORY AND PLAN OF OPERATION**

CMG Mortgage Reinsurance Company was incorporated May 27, 1999, pursuant to the laws of the State of Wisconsin, and commenced business on August 26, 1999. CMG Re was formed as a jointly owned subsidiary of CUNA Mutual Investment Corporation ("CMIC") and PMI Mortgage Insurance Corporation ("PMI"), as an adjunct corporation in the parent companies' strategic alliance for the joint ownership and operation of CMG Mortgage Insurance Company ("CMG"). Each of the two parent companies contributed initial capital of \$1.5 million to CMG Re in May 1999. CMG Re is licensed solely in Wisconsin, having licensure authority to conduct mortgage guaranty insurance business.

CMG Re was established to assume reinsurance for excess coverages on residential mortgage guaranty insurance that is written on a direct basis by CMG. CMG Re reinsures from CMG coverages of up to 25% of an insured mortgage loan, the coverages being excess of the 25% of the insured mortgage loan that are retained by CMG.

CMG Re's reinsurance is for coverages on primary mortgage guaranty insurance products that are offered by CMG, currently, the CMG policies insuring first-lien residential mortgage loans that are originated by credit unions or credit union organizations to its members. Primary mortgage guaranty insurance provides mortgage loan default protection to loan origination lenders on individual loans. The insurance covers unpaid loan principal, delinquent interest and certain expenses associated with loan default and subsequent foreclosure in the event that the mortgage borrower defaults on an insured loan.

The group's insurance policies cover mortgage loans on owner occupied one-to-four family homes. Mortgage guaranty insurance coverages may not be terminated by a mortgage insurer except in the event of non-payment of premiums, and mortgage guaranty policies remain renewable at the option of the insured lender. An insured lender may elect to cancel insurance coverages at any time, upon the repayment or termination of the insured loan or upon the mortgage borrower's attainment of sufficient equity in the insured property.

CMIC and PMI each own a 50% interest in the capital stock of each of the three CMG mortgage guaranty insurers, including CMG, CMG Re, and CMG Mortgage Assurance

Company ("CMGA"). The objective of the CMG joint venture between CMIC and PMI is to establish a strategic alliance through which to offer mortgage guaranty insurance products and services to credit unions that originate residential mortgage loans. The strategic alliance was undertaken to combine and employ the expertise of the two parent organizations, with PMI contributing its specialized knowledge and business systems for mortgage guaranty insurance operations, and with CMIC having close business association with and specialized knowledge of the credit union industry. The CMG mortgage insurance companies do not have their own employees, and their operating functions are provided by affiliated companies within the two parent holding company organizations, pursuant to numerous affiliated services agreements. CMG Re does not conduct policy administration, actuarial, marketing, or underwriting operations apart from those operations conducted on behalf of CMG Mortgage Insurance Company. Further discussion of affiliated relationships and affiliated services agreements is included in the section of this report captioned "Affiliated Companies."

The following table is a summary of premiums written by CMG Re in 2002. The growth of the company is discussed in the Financial Data section of this report.

<b>Line of Business</b>	<b>Direct Premium</b>	<b>Reinsurance Assumed</b>	<b>Reinsurance Ceded</b>	<b>Net Premium</b>
Mortgage guaranty	<u>\$0</u>	<u>\$2,784,376</u>	<u>\$0</u>	<u>\$2,784,376</u>
Total All Lines	<u>\$0</u>	<u>\$2,784,376</u>	<u>\$0</u>	<u>\$2,784,376</u>

Prior to the establishment of CMG Re in 1999, excess coverages written by CMG were ceded to an affiliate of PMI. Cessions under the former reinsurance arrangement terminated effective June 30, 1999. Thereafter, all CMG excess coverages on new policies have been ceded to and assumed by CMG Re.

The total premiums for excess coverages ceded by CMG in 2002 were \$4.0 million, equal to 8% percent of CMG's annual total gross written premium, of which CMG Re assumed \$2.8 million. CMG Re management anticipates that, in the intermediate term, CMG will continue to cede approximately nine percent of its annual total gross written risks.

### III. MANAGEMENT AND CONTROL

#### Board of Directors

The board of directors consists of eight members. Directors are elected annually to serve a one-year term. Officers are elected at the board's annual meeting.

Each member of the CMG Re board of directors is a senior executive in one of the two immediate parent companies, CMIC and PMI, and may also serve as an executive or a director of one or more additional companies within the respective holding companies. CMIC and PMI each have the right to designate the same number of directors to the board of CMG Re, and to vote their respective shares in favor of their respective designees. As provided in the CMG, CMG Re, and CMGA Shareholders Agreements, each director of CMG Re also serves as a director of CMG and of CMGA, and the boards of directors of the three CMG mortgage guaranty insurers have common membership. The board members currently receive no compensation for serving on the board.

Currently the board of directors consists of the following persons:

<b>Name and Residence</b>	<b>Principal Occupation</b>	<b>Term Expires</b>
Walter E. Campion Danville, CA	Sr. VP, Claims & Loss Mitigation PMI Group	2003
James R. McCourt Sun Prairie, WI	Sr. VP, Claims & Loss Mitigation CUNA Mutual Group	2003
Daniel E. Meylink, Sr. Middleton, WI	Chief Officer, Lending Solutions Group CUNA Mutual Group	2003
Peter Pannes San Anselmo, CA	Sr. Vice President & General Manager CMG Mortgage Insurance Company	2003
Faye A. Patzner Middleton, WI	Chief Legal Officer CUNA Mutual Group	2003
Kathleen R. Schroeder Novato, CA	Sr. Vice President & General Manager CMG Mortgage Insurance Company	2003
Arthur P. Slepian San Francisco, CA	Senior Vice President PMI Capital Corp	2003
Stephen L. Smith Alamo, CA	President & COO PMI Mortgage Insurance Company	2003

## Officers of the Company

The officers of CMG Mortgage Reinsurance Company are appointed by the directors at the annual meeting of the CMG Re board of directors, to serve a one-year term.

Each officer of CMG Re is an officer in one of the two immediate parent companies, CMIC and PMI, and may also serve as an officer of one or more additional companies within the respective holding companies. Each officer of CMG Re also holds the corresponding office in CMG and in CMGA, and the three CMG mortgage guaranty insurers have a shared corps of executive officers.

As provided in the CMG, CMG Re, and CMGA Shareholders Agreements, the chairman of the board of directors of CMG also serves as the chairman of the boards of CMG Re and CMGA. The shared board chairmanship of CMG, CMG Re, and CMGA shall rotate annually between CMIC and PMI designees, and the president of the boards of directors of the CMG mortgage insurance companies shall be a person designated by CMIC.

CMG Re officers appointed by the board of directors and serving at the time of this examination are as follows:

<b>Name</b>	<b>Office</b>	<b>2002 Compensation</b>
L. Stephen Smith	Chairman of the board	*
Daniel E. Meylink, Sr.	Vice Chairman	*
Michael B. Kitchen	President	*
Donald P. Lofe, Jr.	Treasurer	*
Earl W. Sealy	Secretary	*
James McCourt	Vice President	\$304,876
Peter C. Pannes	Senior Vice President & General Manager	126,149
Kathleen Schroeder	Senior Vice President & General Manager	*
Michael Warner	Vice President – Underwriting & Operations	269,792
Pamela G. Black	Vice President – Information Technology	165,972
Brian Shepherd	Vice President – Sales	179,500

\*The executive compensation numbers include the amounts reported on the National Association of Insurance Commissioners (NAIC) Supplemental Compensation Exhibit filed with this office.



The above individuals' 2002 compensation was not reported. This is further discussed in the section of this report captioned "Summary of Current Examination Results."

### **Committees of the Board**

The company's bylaws provide for the formation of one or more standing committees or other committees of the board, to be appointed by the board of directors. The company currently has one standing committee of the board of directors, having the following membership.

#### **Audit Committee**

James McCourt, Chair  
Arthur Slepian

The Audit Committee is comprised of two members chosen by the board of directors, with equal representation by each of the two joint venture shareholders of CMG. The Audit Committee reviews financial information, systems of internal controls, and the audit process in order to assist the board in its oversight of the company.

### **Executive Committees Other Than Committees of the Board**

CMG Re bylaws provide that management of company operations shall be conducted by a Management Committee composed of from two to six committee members appointed by the CMG board of directors. The Management Committee functions as a board-appointed executive body that, subject to the overriding authority of the board of directors, has authority to act on all matters related to the day-to-day operation of the company so long as such actions are authorized by the board-approved annual business plan and provided that such actions are not specifically reserved to the board of directors. The Management Committee shall act by the affirmative majority of its members, except that the committee shall act by the unanimous vote of all its members with regard to specific matters of business as enumerated in the bylaws.

Members of the Management Committee need not be members of the board of directors. Historically, the practice of the CMG board has been to appoint two CMG directors, with equal representation by each of the two joint venture shareholders of CMG. The bylaws of CMG Re and CMGA also provide for respective board appointment of a Management Committee executive body, and the Management Committees of CMG, CMG Re, and CMGA have common membership. The CMG Management Committee currently has the following membership:

**Management Committee**

Peter Pannes

Kathleen Schroeder

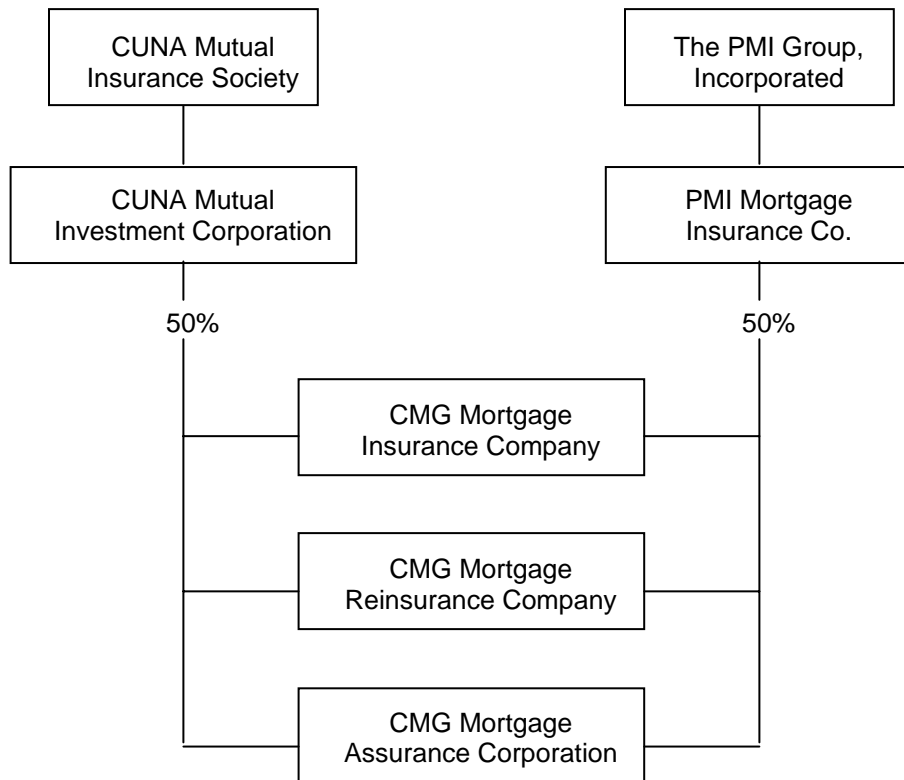
#### **IV. AFFILIATED COMPANIES**

CMG Mortgage Reinsurance Company is a joint venture enterprise, and is a member of two independent holding company systems. The company is jointly owned and controlled by CUNA Mutual Investment Corporation ("CMIC") and PMI Mortgage Insurance Co. ("PMI"), which are in turn wholly owned subsidiaries in the CUNA Mutual Insurance Society ("CMIS") and The PMI Group, Inc. ("TPG"), holding company systems, respectively. CUNA Mutual Insurance Society is a mutual life insurance company domiciled in Wisconsin, and is the holding company parent for the CUNA Mutual Group. The PMI Group, Inc., a corporation domiciled in Delaware and publicly traded on the New York Stock Exchange, is an insurance holding company.

CMIC and PMI each own 50% of the capital stock of CMG, CMG Re, and CMGA, and collectively hold 100% of the equity ownership of each company. CMG Re's management and operations are conducted pursuant to a joint venture strategic alliance of CMIC and PMI, established by the CMG Shareholders Agreement effective September 8, 1994, by the CMG Re Shareholders Agreement effective May 27, 1999, and by the CMGA Shareholders Agreement effective October 1, 2000. All of the business operation functions of the CMG mortgage guaranty insurers, including personnel, legal and administrative services, premium billing and receipt, policy issuance and administration, claims processing and adjudication, asset management and investment, and general accounting and financial reporting operations, are provided to the companies by affiliates from within the CMIS and PMI holding companies, through the provisions of various affiliated services agreements.

The following organizational chart depicts the holding company relationships among the significant affiliates of the company. A brief description of the significant affiliates of CMG Re follows the organizational chart, which is followed by a summary of the service agreement relationships between the company and its affiliates.

**Organizational Chart  
As of December 31, 2002**



**CUNA Mutual Insurance Society (CMIS)**

CUNA Mutual Insurance Society and its affiliates provide group and individual life insurance products, accident and health insurance products, and other financial products and services to credit unions, credit union service organizations, and credit union members. CMIS business activities are conducted in all states, the District of Columbia, and in countries and political jurisdictions throughout the world.

As of December 31, 2002, CMIS's audited financial statements reported total admitted assets of \$2.6 billion, total liabilities of \$2.1 billion and policyholders' capital and surplus of \$500 million. Operations for 2002 produced net income of \$8.4 million on revenues of \$1.5 billion.

### **CUNA Mutual Investment Corporation (CMIC)**

CUNA Mutual Investment Corporation is the holding company for United States based companies in the CUNA Mutual Group. The subsidiaries held by CMIC include 100% ownership of Members Life Insurance Company (a Wisconsin life and health insurer) and CUMIS Insurance Society, Inc. (a Wisconsin property and casualty insurer), 100% ownership of insurance agencies that support the activities of the CUNA Mutual Group, and 50% ownership in each of the three insurers in the CMG Mortgage Insurance Group.

As of December 31, 2002, CMIC's unaudited financial statements reported total assets of \$514 million, total liabilities of \$40 million, and total stockholders' equity of \$474 million. Operations for 2002 produced a net loss of \$20 million after distributing the equity share of affiliated earnings and taxes.

### **The PMI Group, Inc. (TPG)**

The PMI Group, Inc., is an insurance holding company organized in December 1993 pursuant to the laws of the State of Delaware. TPG was originally a wholly owned subsidiary of Allstate Insurance Company ('Allstate'), an insurance subsidiary of The Allstate Corporation. In an April 18, 1995, initial public offering, Allstate sold 36.75 million shares of TPG common stock, representing 70% ownership interest of TPG. Subsequent to the 1995 public offering of TPG, Allstate divested all of its remaining 30% ownership interest in TPG through an exchange of 12.9 million shares of TPG common stock to redeem outstanding Allstate exchangeable notes, and through the sale of 2.8 million shares of TPG common stock that remained in Allstate ownership following the Allstate exchange note redemptions.

Through its subsidiary PMI, TPG provides private mortgage insurance to mortgage lenders in the United States. Other TPG subsidiaries provide mortgage guaranty reinsurance, private mortgage insurance in Australia and New Zealand, home finance industry risk management products and services, and title insurance.

As of December 31, 2002, TPG's audited financial statements reported total assets of \$3.5 billion, total liabilities of \$1.3 billion, and shareholders' equity of \$2.2 billion. Operations for 2002 produced net income of \$346 million on revenues of \$1.1 billion.

**PMI Mortgage Insurance Co. (PMI)**

PMI Mortgage Insurance Co. was incorporated November 10, 1972, as an Arizona stock mortgage guaranty insurance company. From 1973 until 1994, PMI was a wholly owned subsidiary of Allstate Insurance Company. Effective November 28, 1994, Allstate contributed all of the outstanding capital stock of PMI to TPG.

PMI writes residential mortgage guaranty insurance, providing primary insurance coverage on first lien mortgage loans and, beginning in 1997, providing a government sponsored mortgage pool insurance product that is used as an element of credit enhancement for secondary market mortgage loan securities transactions. PMI is licensed to engage in mortgage guaranty insurance in all 50 states and in the District of Columbia.

As of December 31, 2002, PMI's audited statutory financial statements reported total admitted assets of \$2.7 billion, total liabilities of \$2.4 billion, and policyholders' capital and surplus of \$267 million. Operations for 2002 produced net income of \$353 million on premium revenues of \$550 million.

**CMG Mortgage Insurance Company (CMG)**

CMG Mortgage Insurance Company was originally incorporated in 1980 as an Illinois domiciled mortgage guaranty insurer. On April 14, 1994, CUNA Mutual Investment Corporation purchased 100% of the capital stock of CMG. On June 23, 1994, PMI purchased from CMIC 45% of the issued and outstanding stock of CMG, and on September 8, 1994, CMIC and PMI executed the CMG Shareholders Agreement that established a contractual joint venture arrangement and joint management of CMG under a strategic alliance of CMIC and PMI.

CMG resumed writing new business in 1994, and redomiciled to Wisconsin effective November 30, 1994. PMI's ownership interest in CMG increased to 50% in 1998 through PMI's purchase of 200,000 additional shares of CMG capital stock, and presently CMIC and PMI each hold equal 50% ownership interests in the capital stock of CMG. CMG is licensed in 49 states and the District of Columbia, and issues mortgage guaranty insurance policies on first-lien residential mortgage loans originated by credit unions.

As of December 31, 2002, CMG's audited statutory financial statements reported total admitted assets of \$184 million, total liabilities of \$103 million, and policyholders' capital and surplus of \$81 million. Operations for 2002 produced net income of \$11 million on revenues of \$40 million.

#### **CMG Mortgage Assurance Company (CMGA)**

CMG Mortgage Assurance Company was originally organized in 1969 as a California domiciled mortgage guaranty insurer, under the name Investors Mortgage Insurance Company of California. The name was changed to Investors Equity Insurance Company, Inc. (IEIC), effective September 23, 1980. In December 1981, CMG acquired control of 100% of the capital stock of IEIC when IEIC's parent merged into CMG. IEIC ceased writing new business in 1986. In 1994, following CMIC's acquisition of CMG, CMG paid to CMIC an extraordinary dividend consisting of 100% of the capital stock of IEIC. In 1999, IEIC changed its name to CMG Mortgage Assurance Company, and on June 1, 2000, CMGA redomiciled to Wisconsin.

Effective October 1, 2000, PMI purchased from CMIC 50% of the capital stock of CMGA, and CMGA became a jointly owned subsidiary of CMIC and PMI. CMGA is licensed as a mortgage guaranty insurer. The joint venture ownership of CMGA was established to provide insurance coverages on junior lien second-mortgage loans issued by credit unions to their credit union members. CMGA began writing business on these coverages in the third quarter of 2001.

As of December 31, 2002, CMGA's audited statutory financial statements reported total admitted assets of \$9.4 million, total liabilities of \$1.1 million, and policyholders' capital and surplus of \$8.3 million. Operations for 2002 produced a net loss of \$18,031 on revenues of \$46,349.

#### **Affiliate Agreements**

As previously described, each of the three CMG mortgage guaranty insurers is organized as a joint venture enterprise by CMIC and PMI, with each parent organization having responsibility for specified portions of the operations and management of CMG, CMG Re, and CMGA. The rights and responsibilities of affiliates who participate in the joint venture are formalized in agreements between CMIC and PMI (and their affiliates) and each respective CMG

mortgage insurance company. Affiliate agreements that pertain to CMG Re are summarized below. Each CMG Re affiliated agreement became effective May 27, 1999, concurrent with the formation of CMG Re and the adoption of the CMG Re Shareholders Agreement.

#### **PMI Services Agreement**

Pursuant to the PMI Services Agreement, PMI provides the following services:

1. General Management—management assistance in accordance with the Shareholders Agreement, including but not limited to services of specified management personnel,
2. Actuarial Services,
3. Accounting Services, and
4. Legal and Government Relations

In compensation to PMI for services provided, CMG Re pays to PMI a quarterly service fee based on actual cost of services. The agreement includes detailed performance standards for PMI services. The agreement is continuous until the termination of the CMG Re Shareholders Agreement. CMG Re or PMI may terminate the agreement if the other party is in material default for sixty days following notice of default.

#### **CMIC Services Agreement**

Pursuant to the CMIC Services Agreement, CMIC provides the following services:

1. General Management—management assistance in accordance with the Shareholders Agreement, including but not limited to services of specified management personnel,
2. Purchase of insurance coverages, including coverages for directors, officers and employees,
3. Investment Accounting Services,
4. Legal and Government Relations, including those generally related to maintenance of insurance licenses, agent and agency licensing, corporate transactions, and general corporate governance,
5. Federal Income Tax Return Filings, and
6. Facilities Management and Administration.

In compensation to CMIC for services provided, CMG Re pays to CMIC a quarterly service fee based on actual cost of services. The agreement includes detailed performance standards for CMIC services. The agreement is continuous until the termination of the CMG Re



Shareholders Agreement. CMG Re or CMIC may terminate the agreement if the other party is in material default for sixty days following notice of default.

This agreement was restated in 2003. The restated agreement no longer provides completion of the company's tax returns and settlement under the agreement is now done on a monthly basis.

#### **Members Capital Advisors, Inc. Investment Advisory Agreement**

Pursuant to the Investment Advisory Agreement, CMG Re appointed Members Capital Advisors, Inc. ("MCA"), to act as CMG Re's sole investment advisor and investment portfolio manager. MCA, a duly licensed registered investment advisor domiciled in the State of Iowa, is 50% owned by CMIC and 50% owned by CUNA Mutual Life Insurance Company ("CMLIC"), an Iowa domiciled life insurer. CMIS and its affiliates and CMLIC are affiliated through common management and by virtue of an Agreement of Permanent Affiliation effective July 1, 1990.

Specific services provided to CMG Re by MCA are the following:

1. Makes investment decisions and is responsible for investment and reinvestment of the CMG Re investment securities portfolio,
2. Performs research, statistical analysis and continuous supervision of the CMG Re portfolio,
3. Provides to CMG Re and its agent the information required to prepare and file all necessary statutory statements, tax returns, and any other reports or returns of a regulatory nature,
4. Monitors systems and procedures for proper functioning of all investment activities to ensure compliance with the requirements of applicable federal and state laws, rules, and regulations,
5. Renders any periodic and special reports reasonably requested.

In compensation to MCA for services provided, CMG Re pays to MCA a monthly service fee based on a fractional percentage of the end-of-month value of securities and cash managed by the advisor. The agreement is continuous until termination of the CMIC Services Agreement between CMG Re and CMIC. CMG Re or MCA may terminate the agreement in the event of the default of the other party. If MCA fails to meet the performance standards of the contract, the contract may be terminated by thirty days written notice to MCA given either by CMG Re or by CMIC.

### **CMG Reinsurance Services Agreement**

Pursuant to the CMG Reinsurance Services Agreement with CMG Re, CMG shall provide to CMG Re general management assistance services, including, but not limited to the services of CMG's management personnel, necessary for the operation of the reinsurance business conducted by CMG Re. In compensation to CMG for services provided, CMG Re pays to CMG a quarterly service fee based on actual cost of services. The agreement provides that the performance standards for CMG services shall be that of best efforts and the exercise of the highest degree of professional competence. The agreement may be terminated by either party providing 60 days written notice in the event that CMG Re no longer reinsurers any of CMG's business. Either party may terminate the agreement at any time if the other party is in default for 60 days following written notice of default.

### **Trade Name License Agreement**

Pursuant to the Trade Name License Agreement, CMIS granted to CMG Re a royalty-free, non-exclusive right and license in the United States to use the term "CMG," a CUNA Mutual Group trade name, as part of CMG Re's corporate name, corporate trade name, and corporate trademarks and service marks. The agreement establishes requirements and prohibitions on the company's authority to use the term "CMG." The agreement provides that any use of the mark by CMG Re shall inure for the benefit of CUNA Mutual Group, and provides that CMG Re acknowledges the validity of the mark "CMG" and CUNA Mutual Group's exclusive right, title, and interest in the mark. So long as CMG Re shall make regular commercial use of the authorized trademark, the agreement is continuous until the termination of the CMG Re Shareholders Agreement or upon CMG Re's violation of the contract provisions for CUNA's exclusive rights under the contract, CMG Re's assignment of the contract, or CMG Re's improper use of the trademark. CMG Re may terminate the contract upon 30 days written notice.

### **Software License Agreement**

Pursuant to the Software License Agreement, PMI granted to CMG Re a non-exclusive right to use specified, agreed upon items of computer software that PMI or any member of the PMI Group has the right to license. The contracted software is used by members of the

PMI group to perform underwriting or other services, for which PMI either has all right, title and interest or has the right to license. The agreement provides that use of the software shall be limited to CMG Re, that the software will be used solely for the processing of CMG Re's own business which is originated in the credit union system, that CMG Re shall not modify, adapt, translate, disassemble, decompile, reverse engineer or attempt to derive source code for the software, and that the company shall not make the software available to PMI competitors. CMG Re may terminate the agreement upon written notice to PMI. PMI may terminate the agreement in the event that CMG Re or CUNA violates any material provision of the agreement, if CMG Re ceases operations, or if CMG Re fails to use the software for any 180-day period.

## **V. REINSURANCE**

The reinsurance portfolio and strategy of CMG Mortgage Reinsurance Company is described below. CMG Re has one assumption reinsurance agreement with its affiliate CMG, and is not party to any ceding reinsurance agreement. The company's sole reinsurance contract contains a proper insolvency provision.

In certain jurisdictions a direct writer of mortgage guaranty insurance is limited to a maximum retention equal to 25% of the indebtedness of the borrower on the insured loan. The CMG Re assumption reinsurance treaty with CMG was undertaken by CMG primarily for regulatory compliance purposes, to enable CMG to satisfy limitations established by various jurisdictions regarding the proportionate amount of risk that a direct writer of mortgage guaranty insurance is permitted to retain for its own account.

Pursuant to the CMG Re reinsurance assumption treaty, CMG cedes to CMG Re and CMG Re assumes coverages on primary residential mortgage guaranty insurance in excess of 25% of the insured mortgage loan amount, up to a maximum of 25% of the insured mortgage loan amount.

The treaty between CMG and CMG Re became effective July 1, 1999, for CMG cession of new business written on or after July 1, 1999, and replaced a prior reinsurance agreement between CMG as direct writer and Residential Guaranty Company ("RGC", an affiliate of PMI) as the reinsurer of a portion of coverages written by CMG. The coverage provisions of the terminated agreement between CMG and RGC were identical to those of the present treaty between CMG and CMG Re. The treaty between CMG and RGC terminated pursuant to the contract effective June 30, 1999, and remains in runoff until the CMG gross risk in force on the subject business is reduced to zero.

In 2002, CMG had direct written premium of \$49,485,390, ceded written premiums of \$1,043,265 to RGC, and ceded written premium of \$2,784,365 to CMG Re.

## **VI. FINANCIAL DATA**

The following financial statements reflect the financial condition of the company as reported in the December 31, 2002, annual statement to the Commissioner of Insurance. Also included in this section are schedules that reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

**CMG Mortgage Reinsurance Company**  
**Assets**  
**As of December 31, 2002**

	<b>Assets</b>	<b>Nonadmitted Assets</b>	<b>Net Admitted Assets</b>
Bonds	\$7,064,663	\$	\$7,064,663
Short-term investments	372,157		372,157
Agents' balances or uncollected premiums:			
Premiums and agents' balances in course of collection	367,271		367,271
Federal and foreign income tax recoverable and interest thereon	250,820	62,705	188,115
Interest, dividends, and real estate income due and accrued	<u>69,037</u>	<u>          </u>	<u>69,037</u>
Total Assets	<u>\$8,123,948</u>	<u>\$62,705</u>	<u>\$8,061,243</u>

**CMG Mortgage Reinsurance company**  
**Liabilities, Surplus, and Other Funds**  
**As of December 31, 2002**

Losses	\$ 284,950	
Federal and foreign income taxes	62,326	
Unearned premiums	243,383	
Payable to parent, subsidiaries, and affiliates	619,220	
Write-ins for liabilities:		
Reserve for contingencies	<u>2,879,705</u>	
Total Liabilities		\$4,089,584
Common capital stock	2,000,000	
Gross paid in and contributed surplus	1,000,000	
Unassigned funds (surplus)	<u>971,659</u>	
Surplus as Regards Policyholders		<u>3,971,659</u>
Total Liabilities and Surplus		<u>\$8,061,243</u>

**CMG Mortgage Reinsurance Company**  
**Summary of Operations**  
**For the Year 2002**

**Underwriting Income**

Premiums earned		\$2,709,208
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Deductions:

Losses incurred	\$ 182,723	
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Other underwriting expenses incurred	858,796	
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Write-ins for underwriting deductions:

Increase in reserve for contingencies	<u>1,354,604</u>	
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Total underwriting deductions		<u>2,396,123</u>
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Net underwriting gain or (loss)		313,085
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**Investment Income**

Net investment income earned	220,040	
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Net realized capital gains or (losses)	<u>(1,867)</u>	
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Net investment gain or (loss)		<u>218,173</u>
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Net income (loss) after dividends to policyholders but before federal and foreign income taxes		531,258
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Federal and foreign income taxes incurred		<u>204,899</u>
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Net Income		<u>\$ 326,359</u>
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**CMG Mortgage Reinsurance Company**  
**Cash Flow**  
**As of December 31, 2002**

Premiums collected net of reinsurance	\$2,563,466	
Deduct:		
Underwriting expenses paid	<u>858,796</u>	
Cash from underwriting		\$1,704,670
Net investment income		191,920
Deduct:		
Federal income taxes paid (recovered)	<u>(37,000)</u>	
Net cash from operations		\$1,859,590
Proceeds from investments sold, matured, or repaid:		
Bonds	2,478,516	
Miscellaneous proceeds	<u>28,000</u>	
Total investment proceeds		2,506,516
Cost of investments acquired (long-term only):		
Bonds	<u>4,617,229</u>	
Net cash from investments		(2,110,713)
Cash provided from financing and miscellaneous sources:		
Net transfers from affiliates		44,686
Net cash from financing and miscellaneous sources		<u>44,686</u>
Net change in cash and short-term investments		(206,437)
<b>Reconciliation</b>		
Cash and short-term investments,		
December 31, 2001		<u>578,593</u>
Cash and short-term investments,		
December 31, 2002		<u>\$ 372,156</u>

**CMG Mortgage Reinsurance Company**  
**Policyholders Position Calculation**  
**December 31, 2002**

Surplus as regards policyholders	\$3,971,659	
Contingency reserve	<u>2,879,705</u>	
Total policyholders position		\$6,851,364
Net minimum policyholders' position:		
Individual loans:		
Loan-to-value more than 75%	<u>\$2,924,943</u>	
Total individual loans	<u>2,924,943</u>	
Total minimum policyholder position		<u>2,924,943</u>
Excess of total policyholders' position over minimum policyholders' position		<u>\$3,926,421</u>

**CMG Mortgage Reinsurance Company  
Reconciliation and Analysis of Surplus  
For the Three-Year Period Ending December 31, 2002**

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>
Surplus, beginning of year	\$3,605,685	\$3,068,470	\$3,021,758	\$ 0
Net income	326,359	388,715	46,712	21,758
Change in net deferred income tax	52,820	(19,632)		
Change in non-admitted assets	(13,205)	4,908		
Cumulative effect of changes in accounting principles		163,224		
Capital changes:				
Paid-in				2,000,000
Surplus changes				
Paid-in				1,000,000
Surplus, end of year	<u>\$3,971,659</u>	<u>\$3,605,685</u>	<u>\$3,068,470</u>	<u>\$3,021,758</u>

**CMG Mortgage Reinsurance Company  
Insurance Regulatory Information System  
For the Three-Year Period Ending December 31, 2002**

The following is a summary of NAIC Insurance Regulatory Information System (IRIS) results for the period under examination. Exceptional ratios are denoted with asterisks. A discussion of the exceptional ratios may be found after the IRIS ratios.

	<b>Ratio</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>
#1	Gross Premium to Surplus	70.0%	53.0%	35.0%	8.0%
#2	Net Premium to Surplus	70.0	53.0	35.0	8.0
#3	Change in Net Writings	45.0*	78.0*	357.0*	999.0*
#4	Surplus Aid to Surplus	0.0	0.0	0.0	0.0
#5	Two-Year Overall Operating Ratio	75.0	66.0	57.0	50.0
#6	Investment Yield	3.4*	4.5*	5.6	3.9*
#7	Change in Surplus	11.0	17.0	3.0	999.0*
#8	Liabilities to Liquid Assets	54.0	41.0	27.0	10.0
#9	Agents' Balances to Surplus	9.0	4.0	2.0	5.0
#10	One-Year Reserve Devel. to Surplus	0.0	-1.0	0.0	0.0
#11	Two-Year Reserve Devel. to Surplus	-1.0	0.0	0.0	0.0
#12	Estimated Current Reserve Def. To Surplus	-5.0	-2.0	0.0	0.0

IRIS ratio No. 3, Change in Net Writings, reflects the increase or decrease in net premium written reported as a percentage of net premium written in the prior year. The

exceptional results for the examination period are primarily due to the fact the company was established and began operations in 1999. As noted the ratio has decreased as the company continues to assume business from CMG.

IRIS ratio number 6 evaluates the yield on investments compared to annual average cash and total invested assets. The company's unusual results in 2002 and 2001 for ratio number 6 reflects the relatively low investment yield environment that prevailed in the financial markets in those years. The unusual result for 1999 is a result of the company starting business mid-year.

IRIS ratio number 7, Change in Surplus, is a measure of the improvement or deterioration in the company's financial condition during the year. The unusual results in 1999 are again related to the company being established in that year.

#### **Growth of CMG Mortgage Reinsurance Company**

<b>Year</b>	<b>Admitted Assets</b>	<b>Liabilities</b>	<b>Surplus As Regards Policyholders</b>	<b>Net Income</b>
2002	\$8,061,243	\$4,089,584	\$3,971,659	\$326,359
2001	5,870,189	2,264,505	3,605,684	388,715
2000	4,161,466	1,092,996	3,068,470	46,712
1999	3,355,884	334,126	3,021,758	21,758

<b>Year</b>	<b>Gross Premium Written</b>	<b>Net Premium Written</b>	<b>Premium Earned</b>	<b>Loss And LAE Ratio</b>	<b>Expense Ratio</b>	<b>Combined Ratio</b>
2002	\$2,784,376	\$2,784,376	\$2,709,208	6.7%	79.5%	86.2%
2001	1,916,574	1,916,574	1,853,458	3.8	78.4	82.2
2000	1,078,913	1,078,913	987,560	3.1	75.4	78.5
1999	236,159	236,159	222,413	0.9	77.1	78.0

The company commenced business in the second half of 1999 and assumes reinsurance entirely from its affiliate, CMG Mortgage Insurance Company. The company increased its premium written in the examination period by 1,079% as CMG now primarily cedes its business to the company.

**Reconciliation of Surplus per Examination**

The current examination did not make any reclassification of account balances or adjustments to surplus as reported by the company at December 31, 2002.

## VII. SUMMARY OF EXAMINATION RESULTS

### Compliance with Prior Examination Report Recommendations

There were two specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Conflict of Interest Disclosures—It is recommended that the company's officers, directors, and key employees annually execute and submit conflict of interest disclosure to the company, and that the company retain such disclosures during the period from one examination to the subsequent examination, in compliance with the directive of the Commissioner.

Action—Compliance

2. Affiliated Agreements—It is recommended that the company comply with the terms of its intercompany agreements or amend such agreements to reflect the actual practice for provision of services and allocation of costs, and that the company ensure that all of its agreements with affiliates are maintained so as to reflect the substance of all transactions and allocations between respective contracting parties.

Action—Compliance

## **Summary of Current Examination Results**

### **Biographical Reports**

Pursuant to s. Ins 6.52, Wis. Adm. Code, the biographical data relating to company officers and directors should be filed with this office within 15 days after such appointment or election. One director's biographical report was not filed within this time frame. During fieldwork the company provided a biographical report for this director, however, it did not include all the information as required by s. Ins 6.52, Wis. Adm. Code. It is recommended that the company file biographical reports of its directors within 15 days of election and that the biographical sketch include the information outlined in form B of s. Ins 6.52, Wis. Adm. Code.

### **Executive Compensation**

The examination review of the Wisconsin Report on Executive Compensation (Form 22-060) for 2002 noted the company is not completing this form but is completing the NAIC Supplemental Compensation Exhibit in place of the Wisconsin Report on Executive Compensation annual supplement. It is noted that the directions for the NAIC Supplemental Exhibit and those for the Wisconsin Report of Executive Compensation vary slightly and the company should be reporting compensation to this office on the required annual supplement. The executive compensation form included the chief executive officer, however, it was noted this was not an appointed officer position in the section of this report captioned "Management and Control." Testing also disclosed that the company should have reported the president due to the fact his salary exceeded the threshold for reporting. In addition, an amount reported for one of the offices did not reconcile to the detail provided. For officers who are PMI employees, the amounts reported on the form excluded the amounts for executive stock options. It is recommended that the company complete the Wisconsin Report on Executive Compensation (Form 22-060) in accordance with its instructions.

### **Affiliated Transactions**

Examination review of the payable to PMI identified that the amount reported on the annual statement did not trace to the general ledger. In addition, the balance had not been settled to date. Pursuant to the service agreement with PMI, these balances should be settled

quarterly. It is recommended that the company settle intercompany balances in accordance with the affiliated contracts and ensure that the amounts on the annual statement trace to the company's general ledger.



## **VIII. CONCLUSION**

CMG Mortgage Reinsurance Company's financial statements as of December 31, 2002, reported total admitted assets of \$8,061,243, total liabilities of \$4,089,584, and policyholders' capital and surplus of \$3,971,659. No reclassifications or adjustments were made to surplus as a result of the examination.

CMG Mortgage Reinsurance Company was incorporated May 27, 1999, as a jointly owned subsidiary of CMIC and PMI, authorized as a mortgage guaranty insurer licensed solely in the State of Wisconsin. The company commenced business August 26, 1999. CMIC and PMI also each own 50% equity interest in CMG Mortgage Insurance Company and CMG Mortgage Assurance Company. CMG, CMG Re, and CMGA, the three insurers that comprise the CMG mortgage insurance group, are each managed and operated by CMIC and PMI as a joint venture enterprise, pursuant to respective Shareholder Agreements established for each of the three insurers in the group. A strategic alliance of CMIC and PMI, the group exists to provide mortgage guaranty products and services to credit unions who originate residential mortgage loans.

The joint venture ownership of CMG Re was established to assume from CMG Mortgage Insurance Company mortgage loan reinsurance coverages of up to 25% of individual mortgage loans written on a direct basis by CMG, the CMG Re coverages being excess of coverages for up to 25% of each insured mortgage loan that are retained by CMG. CMG Re assumed written premium of \$2,784,376 from CMG in 2002.

The company complied with all of the prior examination recommendations. The current examination resulted in three recommendations as summarized on the following page.

## IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 29 - Biographical Reports—It is recommended that the company file biographical reports of its directors within 15 days of election and that the biographical sketch include the information outlined in form B of s. Ins 6.52, Wis. Adm. Code.
2. Page 29 - Executive Compensation—It is recommended that the company complete the Wisconsin Report on Executive Compensation (Form 22-060) in accordance with its instructions.
2. Page 30 - Affiliated Transactions—It is recommended that the company settle intercompany balances in accordance with the affiliated contracts and ensure that the amounts on the annual statement trace to the company's general ledger.

## **X. ACKNOWLEDGMENT**

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

<b>Name</b>	<b>Title</b>
Ryan Hanson	Insurance Financial Examiner
Amy Wolff	Insurance Financial Examiner
Randy Milquet	Insurance Financial Examiner—Advanced

Respectfully submitted,

Danielle C. Rogacki  
Examiner-in-Charge